

New Construction by the Numbers (in Oregon)

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So you're buying a never-before-slept-in, brand spanking new home? Congratulations! There are a few things that are just a little bit different than the purchase of an existing home and worth knowing.

If the all words on this page (so many words) are making you sleepy (so sleepy), here's the takeaway:

- There's a good chance you're going to be paying an extra title insurance premium at closing, equal to about \$2 per \$1000 of your loan amount.
- We're going to estimate your property taxes. We usually come close, but you won't know the real amount of taxes until the assessor sends the bill in October.
- Because we are estimating taxes, the portion of your monthly payment set aside to pay taxes will also be an estimate. This estimate will be adjusted (usually in January) after the tax bill comes. At this time, you may get a refund check and a big reduction in your monthly payment for the next year. If this happens next January, call us. You'll want to at least save the refund and may want to be put a little extra aside each month to make sure you don't set yourself up for an unpleasant increase in your monthly payment the next January.

Now. For you curious monkeys who must always know, "why?" ...

Title Insurance

What are construction liens?

Oregon's lien laws provide strong protection to contractors and suppliers. If a contractor or supplier is not paid for work performed on or materials delivered to a home, they have a 75-day window during which they can file a lien against the house for the cost of their material and labor.

If your new home is completed 75 days or more before your closing date, as measured from the date a

"completion notice" was recorded with the county, just look for liens on your title report—any present will be paid by your builder at closing.

But what if 75 days have not passed? At closing you (and your lender) can't be certain that all suppliers and contractors have been paid, leaving the potential for future liens. Unfair as it sounds, once the home is yours any liens against it are yours too.

Protection through title insurance

As a solution, title companies offer "early issue" title insurance. The title company researches the builder's financial status and reputation, possibly even requesting lien waivers from sub-contractors. If satisfied, they will issue title policy protecting you and your lender against any unrecorded construction liens.

Do I need it and what's the cost?

Your escrow officer can tell you both the date the "completion notice" was filed and the cost of early issue insurance, if timing dictates it will be required. \$2.00 per \$1000 of loan amount is a pretty good estimate of cost. That's not inexpensive, but imagine how you'd feel if, while you're unpacking boxes and settling in, you received a notice of a lien and a bill from the electrician or plumber who worked on your home.

Property Taxes

What does the Realtors' listing for your new home show for the amount of property taxes? Zero or some other preposterously low number? Wouldn't that be nice? Sadly the tax assessor is going to hit you up for a bit more than that.

Measure 50

To estimate what you're going to pay in taxes on your new home, we need to flash back to 1996, when Oregon voters passed Measure 50. Up until then, county assessors across Oregon would figure a "real market value" for each property—the tax assessor's estimate of the actual property value—and levy taxes on that value. When implemented, Measure 50 decoupled market values from the taxed value, creating a "tax assessed value".

County assessors still go about their business, figuring out a real market value for each property as of January 1st every year—but that's not the value on which taxes are due. The first tax assessed value for each property was 90% of its 1995 real market value. Going forward, Measure 50 capped the increase to the tax assessed value to no more than 3% per year... so long as the property is unchanged.

Changed Property Ratio

But what about a new or changed property like yours? The 3% cap will apply to your new home's tax assessed value going forward, but what will the initial tax assessed value be? With no 1995 real market value to fall back on, the assessor has to use a formula to create your tax assessed value from scratch. That's where those real market values they go to the trouble to figure come in handy. Every year each county assessor figures out the ratio of the assessed value to the market value for properties in the county. This ratio is used to calculate a tax assessed value for new or changed properties and is called the "changed property ratio."

The calculation goes like this:

Real Market Value
x Changed Property Ratio
= Tax Assessed Value

We won't know the real market value the county assessor has assigned to your home until next October

when your property tax bill arrives in your mailbox, but an obvious stand-in for purposes of estimating taxes is your purchase price. In the real world, I've often seen the assessors give a bit lower market value than the price. (Not sure why. Don't complain. It'll make your tax bill lower.)

Millage Rate

The amount of property taxes due on a home is equal to the tax assessed value multiplied by the tax rate, called the "millage rate." The millage rate is made up of permanent rates, pension levies, gap bonds, local option levies, and bond levies, all of which pop up on our ballots fairly often and collectively fund a heck of a lot of our government services (schools, libraries, firefighters, police... stuff like that). The millage rate is expressed in dollars per \$1000. A millage rate of \$25 would work out to \$2500 in tax on \$100,000 of value, for example. That happens to be a pretty close to the 2017/2018 millage rate for Multnomah County.

An example

So let's bring it all home and see how things look with an example:

\$400,000 Purchase Price (standing in for the Real Market Value)
x 50.04% Changed Property Ratio (the 2018 ratio for Multnomah county)
=\$200,160 estimated Tax Assessed Value
x \$25 millage rate (.025)
=\$5004 estimated property taxes

if you dozed off a paragraph or two ago, don't worry about it. We'll find out the changed property ratio and the millage rate for your home with a call to the county tax assessor's office and calculate estimated taxes for you.

And an easy short cut in Multnomah County is to multiply your price times 1.25%. That'll give you a really good estimate to go by.

Property Tax Escrow

Property taxes and homeowners' insurance are included in the monthly payment on the majority of loans that we set up for our clients. At closing, a savings account, called an "escrow", is set up. Every month, when you write your mortgage check, you automatically pay one twelfth of your annual property tax and insurance costs. These funds are deposited into your escrow account. When bills come due, the county and your insurance company send them to your lender to pay. You don't have to think about or budget for these expenses.

Annual Escrow Analysis

Every year, generally in January, you will receive an escrow statement, showing what you paid in to and what your lender paid out of your escrow. Like everything else in life (sigh), you can pretty much count on taxes and insurance to increase over time. On your annual escrow statement, your lender refigures the tax and insurance portion of what you pay monthly, adjusting your payment to include the right amount of money for next year's taxes and insurance. So far, so good.

Well, with new construction, things can get a little weird the first couple of years. We'll estimate your taxes and set up your escrow at closing based on what we anticipate your taxes will be. But come October, there's a good chance you will receive a property tax statement far lower than our estimate. "Cool! Look how cheap my taxes are!" you'll think. And then, when your escrow statement comes in January, it will come with a refund check and a reduction in next year's monthly payment. "Jackpot!" you'll exclaim, "Could this get any better?" Before you pay that holiday Visa bill with your windfall, give us a ring.

Low Assessed Value Year One

Remember we mentioned that the county tax assessor

figures a real market value for your home each year? This real market value is always as of January 1st. January 1st, there's a pretty good chance that your lovely new home was just a twinkle in your builder's eye (and try as they might, the county has not yet figured out how to tax the twinkle in an eye). Or, if your home was under construction, it was a muddy, slip-n-slide of a job site, not yet worth what you're about to pay to buy it.

Thus, the county's tax assessment, for the first year you own your home, will be based on just the value of the lot (or a job site). Next year you are going to be taxed on the full value of the completed home, making that first, cheap tax bill a one-time windfall. Enjoy it, but be aware it creates a little havoc in your escrow account.

Your loan servicer doesn't know the first bill is a one-time thing. They see the cheap taxes, notice they have way more cash held to pay this year's taxes than they need, cut you a refund check for the excess amount and reduce your monthly payment in anticipation of a similarly cheap tax bill next year.

Anticipate an Escrow Shortage Year-Two

But what happens next year when your real, higher, tax bill shows up? Your lender will pay it for you, of course, but it will put your escrow account into a negative balance (maybe even by thousands of dollars). Come the next January, your escrow statement is going to show your account in the red and you will be given two options to remedy the shortage:

1. Your lender will adjust your monthly payment to include an extra amount each month to pay back the shortage in installments.
2. You can write a check for the shortage.

The first option is like getting one over on The Man. Your loan servicer paid your taxes for you, effectively lending you the shortage. You are paying them back

over time with no penalty and no interest. Cool...well, cool, until you see what your monthly payment looks like. Not only is your monthly payment adjusted to pay back the shortage, but it's also adjusted to save for the right amount of taxes next year. This means, for the next year, you are going to be paying double the difference more each month. Ouch.

Since you're probably not thinking, "A year of really big loan payments... sign me up!", the second option might be more appealing. If you get a refund check next year, give us a ring. We'll help you estimate your upcoming shortage (emphasis on "estimate"). If your refund is big enough, you can pop the check into savings, enjoy your year of cheaper mortgage payments and rest easy knowing you have your shortage covered. If your refund check is less than the likely shortage, you'll know how much to save and a year (with lower-than-normal loan payments) in which to do it.

For the Nerds

And for those of you financial nerds (you know who you are), who simply can't resist the siren song of an interest free loan, here's one more idea: Pop your refund check into savings and budget as though you are planning to write a check to cover your escrow shortage... but don't. Instead, let your lender adjust your payment and then dole out your accumulated savings each month to supplement your super-sized mortgage payment. At current interest rates you won't earn much on interest this way (hardly enough to super-size a drive-through meal), but for financial nerds, that's not the point, is it?